

2H08 like 1H01, only maybe worse

Deteriorating envrmnt in 2H08; Indian vendors gain share.

Global IT and BPO outsourcing consultant TPI had its 4Q call on Tuesday. 2HCY08 was significantly weak on the back of few mega deals. Clients focused on near-term profitability with propensity for short-term / small ticket deals. Market share gains achieved by Indian vendors during 2008. Our proprietary CIO Survey (carried out in Dec. by our US software team) also, not surprisingly, shows the lowest IT budget growth expectation in the last two years, with IT budget expected to decline 1.7%. Typically the IT budget growth expectations start optimistic and deteriorate as the year progresses.

2008 showed growth, but dismal 2H08

Total Contract Value (TCV) for 2008 increased 5.6% to \$89.4 bil. Impact of macro turmoil in H2CY08 was clearly visible with TCV declining 22.1% to \$39.1 bil in H2 vs \$50.3 bil in H1. Both Q3 & Q4 were soft in terms of new contracts.

Pick-up might not be around the corner

The second half of 2008 was one of the weakest half-years for TCV performance on record, resembling first half of 2001, the last global recession. H1CY01 saw a 21% decline vs H2CY00 but was followed by a growth of 27.5% in 2H01. Unlike 2001, slowdown is expected to last longer than half a year.

India continues to lead as lower-cost destination

Indian vendors continued to gain market-share during the year. They especially showed strength in Applcn Dev & Maintenance and F&A. Also as per TPI, for Satyam clients looking to switch, it would likely be to another existing relationship as significant body of knowledge exists with outsourcing vendors.

Short-term / small ticket profit-focused orientation of deals

2008 saw average contract duration decline to 5.2 years (shortest ever) with clients focusing on deals producing more near-term profits. Mega deals (TCV > \$1bil) declined to just 3 in 2H08 vs 12 in 1H08 and 7 in 2H07. Ex the mega-deals, the number of contracts (>\$25 mil) remained almost flat yoy in 2H08 at 293.

Stock recovery lagged volume recovery in 2003

Looking at the last downturn, we believe stocks are unlikely to rebound until the upturn in revenue is visible, as we witnessed in July 2002, after 1QFY03 results. We believe the earliest growth could pick up for the IT services majors, assuming early recovery for offshore players, is in Jun 09 qrt, but could even be early 2010.

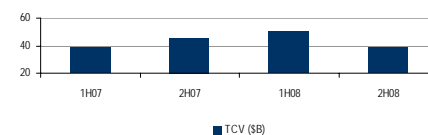
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RESEARCH

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Chart 1: Total Contract Value by half-years (\$B)



Source: TPI

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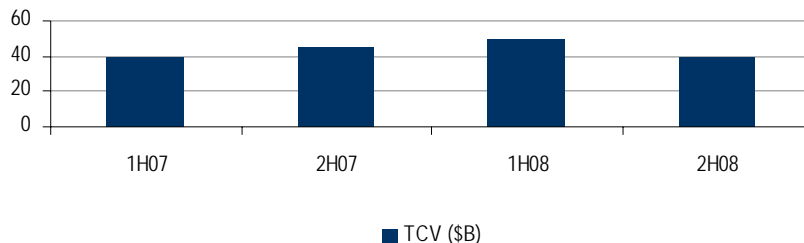
Deteriorating environment in 2H08

Key takeaways from outsourcing consultant, TPIs 4Q call

Impact of economic turmoil in H2CY08 was clearly visible with TCV declining 22.1% to \$39.1 bil in H2 vs \$50.3 bil in H1. Both Q3 and Q4 were soft in terms of new contract awards.

As per TPI, the following trends were seen in Q4 and H2 of CY08.

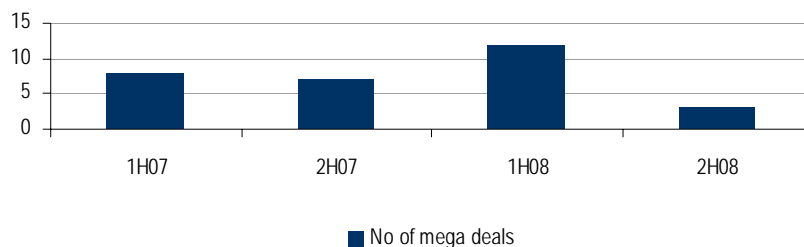
Chart 2: Declining TCV by half-years (\$B)



Source: TPI

No. of mega deals (TCV > \$1B) saw a sharp decline in 2H08, dropping to just 3 from 12 in 1H08

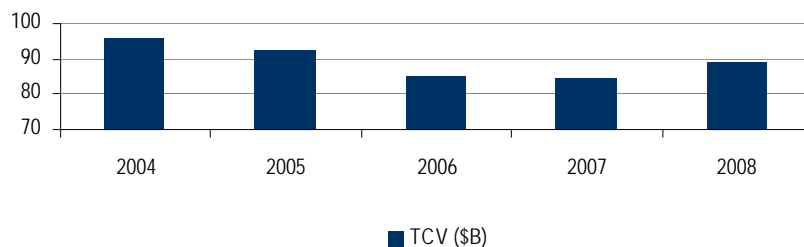
Chart 3: No. of Mega Deals dropped sharply



Source: TPI

Total Contract Value (TCV) for 2008 increased by 5.6% to \$89.4 bil. Total number of contracts awarded in 2008 was the highest ever at 602 (8% y/y)

Chart 4: Total Contract Value (\$B) for 2008 was up led by H1



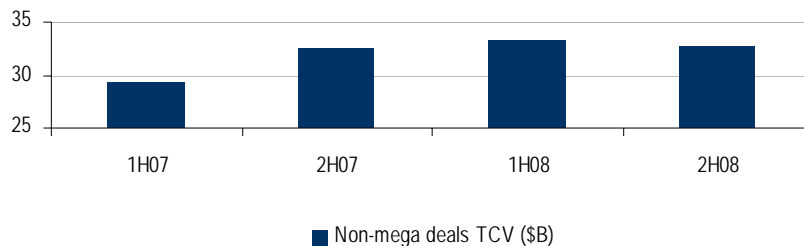
Source: TPI

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India Computer Services

Excluding the mega-deals, TCV in 2H08 was \$32.7 bil, comparable to \$33.3 bil in 1H08. Annualized contract value (ACV) reached a record high of \$17.6B (9.5% growth y/y)

Chart 5: TCV for non-mega deals (\$B) in H2 comparable to H1 & ACV grew yy



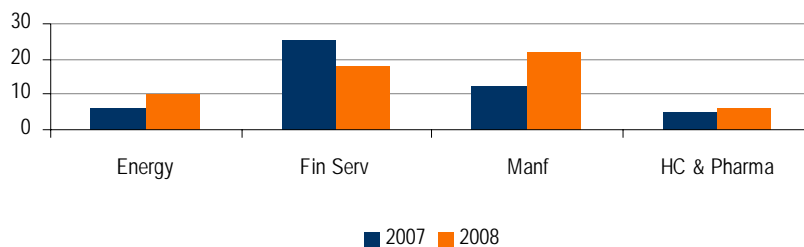
Source: TPI

Energy, healthcare & pharmaceuticals, manufacturing and telecom increased TCV y/y in 2008. TCV in financial services industry was at lowest since 2001 at \$18.1 bil vs \$25.7 in 2007.

Financial services showed a growth in H2 vs H1 chiefly due to the buy-out deals of back-office units (eg: TCS's acquisition of Citi Global Services and Wipro's acquisition of Citi Technology Services). Retail, travel & transport also showed a sharp decline.

Manufacturing, Energy, Pharma showed an increase in TCV while Fin services declined

Chart 6: Vertical-wise TCV (\$B) trends

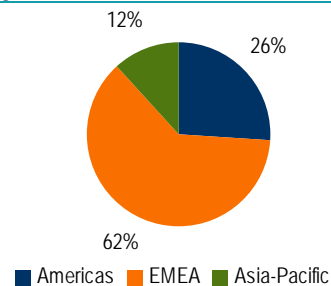


Source: TPI

TCV increased in EMEA y/y while Americas showed a decline. No. of contracts went up from 231 to 271 in EMEA. Both EMEA and Americas showed a drop in 2H vs 1H.

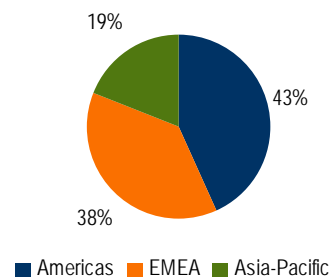
EMEA had a 62% share in the total CY08 ITO contracts while BPO contracts were spread out more evenly (43% Americas, 38% EMEA, 19% Asia). Infrastructure and Network services in IT and Facilities management in BPO remain strong.

Chart 7: 2008 IT Outsourcing Contacts (\$B)



Source: TPI

Chart 8: 2008 BPO Contacts (\$B)



Source: TPI

Our proprietary CIO Survey (carried out by our US software team) not surprisingly shows the lowest IT budget growth expectation in the last two years, with IT budget expected to decline 1.7%. Typically the IT budget growth expectations start optimistic and deteriorate as the year progresses.

Proprietary CIO Survey indicates budget decline, as expected

- **Our CIO Survey has a respondent base of 21 well-recognized US Fortune 1000 CIOs.** While not statistically significant to make any hard conclusions on individual stocks, we believe the survey is useful for its anecdotal value and indications of shifts or validation of vendor perception.
- **IT budget growth expectation of -1.7% for 09, down from intentions for flat growth in our 3Q survey does not surprise us.** This is the lowest expectation level in the last two years. 33% of CIOs anticipate positive 09 IT spending, down from 41% in our prior survey.
- **In the last two years, the expectations for IT budget growth started on an optimistic note and grew progressively weaker as the year progressed.**
- **With about half the CIOs surveyed still finalizing their budgets, clearly the -1.7% growth estimate has potential downside if the economy gets worse.** On the flip side, there is a probability, a small one, albeit, that the -1.7% growth expectation shows upside when the year is all said and done with prospects for an economic recovery in late 2009 or early 2010.

- **Spending on IT consulting & Syst Intgn, and on IT/BPO outsourcing to see lower proportion of spend** with Internal IT staff spend likely to pick up in mix.
- For more details on the survey, pl see [CIO Survey starts negative](#)

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